DIRECT TESTIMONY OF
JULIE M. CANNELL

ON BEHALF OF

SOUTH CAROLINA ELECTRIC AND GAS COMPANY

DOCKET NO. 2004-178-E

Q. PLEASE STATE YOUR NAME AND BUSINESS AFFILIATION.

A. My name is Julie M. Cannell. I am president of J.M. Cannell, Inc., which provides advisory services to electric utility companies and other types of firms and organizations with an interest in the industry. Prior to establishing my firm in February 1997, I was employed by the New York-based investment manager, Lord Abbett & Company, from June 1978 to January 31, 1997, as well as the summer of 1977. During my tenure with Lord Abbett, I was a securities analyst specializing in the electric utility and telecommunications services industries; portfolio manager of America's Utility Fund, an equity utility mutual fund; portfolio manager of numerous institutional equity portfolios, and co-director of Lord Abbett's Equity Research Department. Further information on my background and experience can be found in Appendix A.

Q. PLEASE SUMMARIZE YOUR EXPERIENCE THAT ALLOWS YOU TO PROVIDE TESTIMONY ABOUT THE VIEWPOINT OF INVESTORS.

A. As a securities analyst, I specialized in the electric utility industry and the individual companies comprising it. As a portfolio manager, I applied that knowledge, along with investment fundamentals, toward investment decisions on behalf of institutions and individual investors. And, as an advisor to the industry, a great deal of my work has dealt with investors and their perceptions.

Q. AS AN ANALYST OR PORTFOLIO MANAGER, DID YOU FOLLOW SCE&G?

A. Yes, I did. Both Lord Abbett and America's Utility Fund maintained a holding in the common stock of the Company, and after the formation of a holding company, the common stock of its parent, SCANA Corporation. Additionally, I spent several years as portfolio manager of the SCE&G pension assets that were managed by Lord Abbett.

Q. PLEASE SUMMARIZE THE KEY POINTS OF YOUR TESTIMONY.

A. There are three parts to my testimony.

Investors' Perceptions Related to the Present Proceeding

-- This section reviews the investment community's perceptions of

SCE&G and its parent company SCANA, with specific emphasis on how investors view the present rate proceeding and what it means for the Company. This review is based on a number of recent publications by rating agencies and investment analysts discussing their perceptions of the current regulatory situation of the Company.

How Investors Evaluate Investments in Utility Companies -- This section discusses why investors choose to invest in electric utilities, with particular emphasis on why the regulatory climate in which the utility operates is of such importance to investors. This section of the testimony also discusses why the risk of investing in the electric utility industry has risen substantially in recent years on an industry-wide basis and why markets today react so swiftly and strongly to unfavorable news about a company.

Return on Equity for SCE&G --This section discusses an appropriate ROE for SCE&G from an investor's perspective. In addition to reviewing the testimony submitted by Dr. Burton Malkiel, I will put his recommendation in the context of how the investment community is viewing this regulatory proceeding and the Company's requested ROE. My conclusion is that the Company's proposed ROE of 11.75% is within a range of returns that investors would consider reasonable and constructive.

INVESTORS' PERCEPTIONS OF THIS PROCEEDING

Q. HOW HAVE YOU GAUGED INVESTORS' PERCEPTIONS OF THIS PROCEEDING?

A. To supplement my own knowledge of the industry, I have reviewed various reports of the credit rating agencies and investment analysts related to SCE&G and SCANA. A clear picture of investors' perceptions emerges from these reports, which is very much in keeping with my own perceptions.

Q. HOW DO THE CREDIT RATING AGENCIES VIEW SCE&G, AND THE SOUTH CAROLINA REGULATORY ENVIRONMENT IN WHICH IT OPERATES?

A. A recent written report on the company came from Moody's Investors Service, which rates the Company A1, with a stable outlook. As the report states, much of the reason for the A1 rating and stable outlook is the perceived quality of regulation in South Carolina.

> "**Rating Rationale**
>
> South Carolina Electric & Gas' ("SCE&G" A1 senior secured) ratings are supported by the constructive regulatory relationship the company enjoys with both commissioner's [sic] and staff, a growing service territory with attractive customer demographics, and relatively low cost rates. …

… Essentially the [2002] rate case resolution was viewed positively, as it demonstrated the PSC's long-term planning views and pro-active approach to utility relations and financial health. This is exactly the reason why Moody's is now cautious regarding SCE&G's ability to seek additional rate relief in the near to intermediate term.

Financially, the utility is performing well, and we are favorably disposed to rate regulated utility operations in State's [sic] that are not in the middle of introducing competitive or other deregulation initiatives.

Rating Outlook

Our stable outlook is a function of the inherent stability of the rate regulated operations, and the constructive and supportive relationship the company enjoys with the State Public Service Commission.

What Could Change the Rating – UP

A steady improvement in credit metrics, both leverage and cash flow coverage would be viewed favorably. The timely completion of the remaining construction program for both the jasper[sic] and Lake Murray dam remediation projects, and clarity as to the ability to seek additional rate relief, post completion of the projects, would also be viewed positively.

What Could Change the Rating – DOWN

A degradation to the Company's forecasted credit metrics, either as a result of operational cost pressures, or unexpected delays in completing the construction program. The prospect for additional rate relief is a primary driver of our financial expectations. We also note that the utility's capital expenditures are expected to rise again in 2006, as disclosed in the recently filed Form 10-K.

Recent Developments

On February 10, South Carolina passed legislation that modified the framework of the state's Public Service

> commission, which included a commission nominating committee, several new members to the commission and an Office of Regulatory Staff to represent the public interest. These changes introduce uncertainty as to the commission's overall culture, and potential working relationships with the utilities they regulate.
>
> --March 30, 2004 report: "Credit Opinion: South Carolina Electric & Gas Company

Standard and Poor's also offered a similar opinion last year:

> Standard & Poor's Ratings Services said today that it affirmed its 'A-' long-term corporate credit ratings on SCANA Corp. and its affiliates, South Carolina Electric & Gas Co., (SCE&G) and Public Service Co. of North Carolina Inc. (PSNC). The outlook for all the entities is stable.
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>
> Standard & Poor's also said that the ratings on SCANA, on a consolidated basis, reflect the parent company's current high leverage offset by stable cash flow from regulated electric and gas businesses, constructive regulatory environments, and competitive business positions."
>
> "June 6, 2003 report: "SCANA and Units Long-Term Ratings Affirmed; Short-Term Ratings Lowered to 'A-2.'"

Both of these reports indicate that credit rating agencies see SCE&G and SCANA as financially stable and hence good credit risks. Both note the stable and constructive nature of regulation in South Carolina. The more recent report from Moody's clearly recognizes "that the prospect of additional rate relief is a primary driver" in Moody's financial expectations supporting the A1 rating. The Moody's report also shows that because of the recent changes in the structure and membership of the Commission, the investment community is watching to see if there will be a change in the future course of regulation in South Carolina.

Q. HAVE ANY INSTITUTIONAL INVESTORS RECENTLY EXPRESSED OPINIONS REGARDING SCE&G AND SCANA'S PRESENT REGULATORY SITUATION?

A. Yes, they have. UBS Warburg wrote:

> "Though management does not appear concerned about the recent passage of South Carolina legislation reforming the regulatory processes in the state and the replacement of four out of the state's seven commissioners, we believe these changes could yield a less constructive regulatory environment over time—a key variable we will be monitoring.
>
> Moreover, though we are not expecting a draconian outcome and SCE&G is under-earning its 12.45% allowed ROE (and should continue to do so as its current rate base does not yet encompass the full cost of the Jasper plant and its future operating costs), we still view the reality of the segment entering the rate arena via a full-blown mid-2004 rate case as an underlying risk—especially given the aforementioned regulatory reforms."
>
> April 26, 2004 report: "SCANA Corp.: Comprehensive 1Q Review: Edging Up Assumptions."

Regulatory Research offered an opinion, as well:

> "Given the constructive regulatory climate, we would expect a reasonable outcome in a plant recovery rate proceeding; however, it is not clear if one will be filed in the near term. As issues are resolved and the lower risk profile of the consolidated entity is realized, we expect the shares to trade at a premium. In the meantime, SCG's 4.1% dividend yield is just slightly below the industry average. Accordingly, we are changing our recommendation on the SCG shares to "Buy" from "Hold."

April 2, 2004 report: "SCANA Corp."

Further commentary was offered by Shields & Company:

> "Management's goal is to increase earnings by 4% to 6% annually through 2006, a goal that's achievable but requires support of the South Carolina Public Service Commission (SCPSC). Our forecast incorporates an \$85 million (6%) rate increase effective the first quarter of 2005 and a \$275 million (7.5 million shares) common stock sale mid-2005.
>
> *Earnings Hinge on Outcome of Yet to be Announced Rate Request at SCE&G*
>
> The company's last rate increase in South Carolina was effective February 2003 and totaled \$70.7 million (5.8%). The decision provided for 12.45% return on common equity and included construction work in progress attributable to Jasper (about 60% of estimated completion costs) in rate base. The expected rate filing will primarily reflect non-rate base Jasper investment and its related operating expenses. Since the Jasper investment was reviewed extensively in the prior case, controversy should be minimal. We estimate a filing sometime this summer totaling \$120 million. The commission is required to reach a decision within six months of application so new rates should be in effect for most of 2005. Our forecast incorporates an 11.7% return on common and relief totaling \$80 million effective April 1, 2005.

April 7, 2004 report: "SCANA Corporation."

And A.G. Edwards and Sons also weighed in:

> Roughly \$276 million of the Jasper Plant expenditures were included in the early 2003 rate decision, but additional rate relief is necessary to recognize the full cost of the plant. The upcoming rate decision will be a primary determinant of EPS growth in 2005 and beyond.
>
> Following constructive utility legislation in March of 2004, four new members were added to the seven-member Public Service Commission of South Carolina. The change in commission make-up results in some uncertainty as to the

future treatment, but, given SCG's historical constructive regulatory relationship and the fact that the PSC has recognized a portion of Jasper, we believe the company will be authorized a constructive rate order. In addition, we believe SCG's intention to use deferred synthetic coal tax credits to negate the need for rate relief related to the Lake Murray dam reinforcement project will be well-received by the commission."

April 3, 2004 report: "SCANA Reports Results Well Ahead of Expectations."

Wachovia Securities also addressed the rate case:

"SCANA's utility subsidiaries serve a growing area with competitively priced rates. A historically constructive regulatory climate supports our assumption that investments in new plant will translate into future earnings. The balance sheet has been strengthened with new equity and should continue to improve. Earnings and dividend growth, combined with an attractive current yield, provide an above-average total return potential.

Over the next 12 months, we believe the shares of SCG warrant a valuation range of about $34-40, based on our blended EPS estimates for 2004-05, our estimated 3-5 year EPS growth rate, and a normal P/E multiple of 12-14x. Risks to achieving our expected valuation range may include the company's ability to manage the risks of its gas marketing business in Georgia, changing credit rating agency standards, unplanned nuclear plant outages, and maintaining its relationships with its various regulatory agencies."

--May 28, 2004 report: "Upgrading: CEG, CIN, ETR, FPL, NI, PGN, SCG, SO. Impact of Rising Rates on Current Valuation May be Overdone."

Q. WHAT THEMES DO YOU SEE EXPRESSED IN THESE REPORTS?

A. The opinions offered by these analysts affirm that investors perceive the regulatory climate in South Carolina to be constructive and that this viewpoint is important to the continued attractiveness of investment in SCE&G and SCANA. These statements also indicate --the Warburg statement most especially-- that the investment community expects the constructive regulatory climate to continue and that events are being watched closely to determine if that will prove correct.

Q. DO THE FAVORABLE COMMENTS ABOUT REGULATION IN SOUTH CAROLINA INDICATE THAT INVESTORS PERCEIVE REGULATION IN THE STATE TO BE BIASED TOWARD INVESTORS?

A. Not at all. Investors see regulation in South Carolina as balanced and constructive. By this I mean that regulation has historically balanced the interests of investors and consumers in an even-handed and constructive way –one which I believe benefits all parties.

This conclusion is demonstrated by a recent report by Lehman Brothers that provided a ranking of state utility commissions from an investor perspective. Tier 1 was "Most Shareholder Oriented" and Tier 5 was "Most Consumer Oriented." Lehman Brothers ranked South Carolina in "Tier 3" on this scale – exactly in the middle.[1] This ranking indicates that investors see

[1] Lehman Brothers March 5, 2004 report: "They're Back! Twenty-Six Rate Cases This Year Give Rise to the Regulators."

regulation in South Carolina as fairly balancing the interests of consumers and investors in a way that maximizes the interest of both.

Q. IS IT POSSIBLE FOR A COMMISSION TO BE SEEN AS BEING FAIR TO BOTH CONSUMERS AND INVESTORS?

A. Yes. As discussed in more detail below, what investors value most in utilities is stable earnings and regular dividends supported by consistent and fair regulation. Where regulation is seen as providing such stability, investors are comfortable making capital available to utilities on reasonable terms. Reasonably priced capital greatly benefits the utility's customers in the form of reduced capital costs. Fairness to investors and fairness to customers are not mutually exclusive but actually go hand in hand.

WHY INVESTORS CHOOSE TO INVEST IN ELECTRIC UTILITIES

Q. WHAT GOALS LEAD INVESTORS TO INVEST IN ELECTIC UTILITIES?

A. Historically, electric utilities have been regarded as investment vehicles that provide stable performance through the ups and downs of market cycles and changing economic conditions. Electric utilities have typically earned a reasonable return even when conditions were not favorable for other companies. Accordingly, electric utility stocks have been particularly valuable holdings when conditions were not favorable to investments in more volatile industry sectors. In other words, investors might see greater returns from investment in other industries when times were good, but they would lose less on electric utility stocks when times were not good.

In addition, the reliability of electric utilities' earnings streams permitted most of the companies to continue to pay regular dividends during both good and bad economic cycles. For investors with a need for regular cash income, the prospect of regular dividends has been an important consideration in making a decision to invest in electric utility stocks.

Based on these factors, investors have traditionally viewed electric utility stocks as bond substitutes. In other words, electric utility stocks have provided regular cash returns in the form of dividends and the shares themselves were seen to have a stable underlying value. Electric utilities historically have paid out a large proportion of their earnings as dividends, and their large construction programs have kept them dependent on the capital markets. As a result, electric utility stocks as a group have tended to move closely in line with the direction of interest rates, but in an inverse relationship. That is, utility stock prices rose when interest rates fell, and vice versa. These factors made electric utilities a preferred investment during economic slowdowns or recessions and owning them was a way of balancing the risks in a portfolio of stocks that included stocks in more volatile industries.

Q. HAVE THE RECENT CHANGES IN THE INDUSTRY INCREASED THE RISK OF INVESTING IN ELECTRIC UTILITIES?

A. Yes. Investors now understand that the predictability of the electric utility industry's earnings, across the sector, has been undermined by the restructuring that has taken place in many parts of the country. These risks are in addition to the risks posed by technological, economic, environmental and other policy changes that affect the industry. These increased risks means that investors no longer perceive electric utilities as a group as being as much the "safe havens" they once were.

Investors' goals, however, have not fundamentally changed. They still look to electric utilities primarily as defensive investments, and still look for stable performance and regular dividends as the reason to invest in electric utilities. But investors also understand that the investment risk in electric stocks has risen significantly, and that there is more risk than before that investors' goals in investing in this sector may be frustrated.

In the end, investors have a very large universe of stocks from which to select; with few exceptions, they have no requirement to own electric utility stocks. Consequently, investors now require a higher return for investing in the electric utility industry to balance the increased risk associated with it.

Q. GIVEN SOUTH CAROLINA'S CAREFUL AND CONSERVATIVE APPROACH TO REGULATORY CHANGE, HOW DO THESE CONCERNS AFFECT SCE&G?

A. Markets tend to make judgments about investment risks that apply to industry sectors as a whole. Company specific risk factors are additive to sector risk. In other words, investors first determine the risk involved in investing in a particular sector. They then add to that sector risk the specific risks applicable to individual companies.

Q. IN YOUR EXPERIENCE AS AN ANALYST AND PORTFOLIO MANAGER, COULD A PERCEIVED CHANGE IN A COMPANY'S REGULATORY CLIMATE AFFECT YOUR INVESTMENT OPINION?

A**.** Absolutely. During my tenure as an active investor, the quality of a company's regulatory environment was a critical factor in my assessment of its investment attractiveness. An adverse regulatory decision could be a key determinant in my recommendation or decision to sell a stock already owned or not make an investment in one under consideration.

Q. WHY IS THE PERCEPTION OF REGULATORY CLIMATE OF SUCH IMPORANCE TO INVESTORS?

A. Equity investors today are still seeking companies that can offer stability in earnings and dividends. Fixed income investors look for stable and adequate cash flows to ensure payment of principal and interest when due, as indicated by stable credit ratings. The ability to pay dividends and sustain credit ratings is directly related to the consistency and sufficiency of a utility's earnings, which depend in large part on how the utility is regulated. If there is uncertainty about whether regulation will allow a utility the opportunity to earn a reasonable return in future years, then that uncertainly will lead investors to avoid holding investment positions in the utility, all other things being equal.

As a result, I believe that investors selecting electric utility stocks today place a very high value on consistent and constructive regulation. And with a new round of base rate case filings underway in the industry, I think it likely that the quality of regulation will receive renewed investor attention.

Q. HOW HAS THE INVESTMENT INDUSTRY ITSELF CHANGED IN RECENT YEARS?

A. In recent years, institutional investors and hedge funds have grown dramatically in the amount of capital they control. This growth has had a significant impact on the speed with which the market reacts to unfavorable developments. It has led the market to be much more reactive and much less forgiving than it may have been in the past.

Q. WHY ARE INSTITUTIONAL INVESTORS OF SUCH IMPORTANCE GENERALLY?

A. Because of the sheer size of their investment positions, institutions can effectively direct the course of individual securities, if not the market as a whole. Institutional investors include financial institutions such as mutual funds, investment companies, insurance companies, commercial and investment banks, and various types of public retirement funds. They approach the investment selection process from the standpoint of a portfolio. An investment portfolio is a collection of stocks selected to achieve the highest possible return within a commensurate level of risk. Therefore, institutional investors only keep electric utilities in their portfolios when such stocks contribute to achieving the desired risk/return relationship.

It should be remembered that, generally, the customers of institutional investors are individuals and it is they who ultimately gain or suffer loss from changes in the value of the institution's investments. Anyone who has a stake in a retirement plan, owns a mutual fund, or has a trust fund, for example, is directly or indirectly a client of an institutional investor. But the individuals who make the decisions concerning these investments are paid money managers, and how they see their responsibilities to the clients they serve, and the way that their performance is judged, have a great deal to do with how they react to developments in the market.

Q. WHY ARE INSTITUTIONAL INVESTORS IMPORTANT TO SCE&G AND SCANA?

A. Institutional investors today hold 45% of SCANA's total common shares. Such investors warrant significant attention because they can dramatically change the market for SCANA's shares. Because institutional investors own large blocks of shares relative to the volumes typically traded, their activity in moving in or out of the Company's shares is often noticeable as a significant change in the price and volume of shares being traded for the Company. This change may be picked up by other institutional investors, by the investment community in general, and eventually by individual investors. These other entities will then look to see what is driving this trend in the stock and whether the trend is likely to continue or disappear. If they see support for the trend, they may follow the lead of the firms that initially began to move the market, and by following the leaders, the late movers may further strengthen the trend.

Q. WHY MIGHT AN INSTITUTIONAL INVESTOR CHOOSE NOT TO HOLD INVESTMENTS IN A PARTICULAR ELECTRIC UTILITY?

A. Several factors might be drivers. First, institutional investors have fiduciary responsibilities. For example, managers of pension assets fall under Federal ERISA laws, which mandate that a portfolio manager's decisions meet the so-called "prudent man" standard. That is to say, he or she is expected not to make investment decisions that are unduly risky or to retain stocks that are unduly risky given the investment goals of the portfolio and the function of the stock within it.

In addition, institutional investors have performance pressures. It is not enough for stocks in a portfolio simply to increase in value. Rather, relative performance is what counts. Investment performance is gauged against a market proxy (such as the Standard & Poor's 500 Index) or a peer group of investors (i.e., investors with a similar style, such as value, growth, growth & income, small cap, etc.). Mutual fund rating organizations such as Morningstar track and publicize the relative performance for mutual funds, and various pension consultants perform the same service for their client organizations.

Q. WHAT HAPPENS WHEN AN INSTITUTIONAL INVESTOR UNDERPERFORMS?

A. The results can vary, but eventually, underperformance will result in lost business and personnel changes. Mutual fund shareholders can sell their fund shares. A pension plan sponsor can fire the professional investor or reduce the assets under their investor's management. And, of course, poor performance also disadvantages the individual, who has entrusted his monies to the institution for management.

Q. HOW LONG A PERIOD DOES AN INSTITUTIONAL INVESTOR HAVE BEFORE PERFORMANCE BECOMES AN ISSUE?

A. Again, it can vary. But there is little argument that institutional investors no longer have the luxury of a long time horizon in which to show performance. Investors want results. And with the public visibility that investment results now have (through organizations such as Morningstar and the various pension consultants) and the resulting performance pressure, most investment organizations are now operating with a much shorter time horizon than in years past. Generally speaking, a long investment time horizon today can be as short as 12-18 months. So, a stock that is unlikely to perform within the prescribed time horizon is usually not attractive for purchase or continued investment by an institutional investor.

Q. WHAT DOES THIS MEAN FOR INVESTMENTS IN REGULATED UTILITIES SPECIFICALLY?

A. This shortened time frame means that if there is bad news, institutional investors are more likely to react quickly.

Q. DO ALL INSTITUTIONAL INVESTORS FUNCTION WITHIN THE TIME FRAMES YOU DESCRIBE?

A. No. There is a type of institutional investor called a hedge fund that frequently buys and sells the same stock during the course of a day.

Q. WHAT IMPACT DO HEDGE FUNDS HAVE ON THE MARKET IN GENERAL AND STOCKS IN PARTICULAR?

A. Their impact can be dramatic. Hedge funds are well known for trading in information; their actions are frequently event-driven. Sometimes that information is factual and other times it falls into the category of rumor. Because investors at hedge funds have wide information networks and are in frequent communication with companies and a broad range of other investors, they have the ability and the power to create volatility, which in turn impacts the movement of stock prices. And because the number of hedge funds participating in the market and the funds' assets have grown exponentially in recent years—recent estimates put the numbers at over 5000 firms with assets of $800 billion globally during the second quarter of 2004, with the top 150 U.S. hedge funds' assets at almost $500 billion, compared to 610 firms with $39 billion in assets in 1990—they have become a very strong force both in the market and in stocks in which they are interested. When they like an industry group or a stock, hedge funds can provide substantial support to stock prices. But conversely, when they become disenchanted, their tendency is to sell quickly and without remorse. Although their focus is not on contributing to orderly markets, hedge funds are a formidable presence in the market place and must be reckoned with.

Q. CAN YOU GIVE AN EXAMPLE OF HOW HEDGE FUNDS MIGHT TRAFFIC IN SCANA'S STOCK?

A. Yes. Earlier in the year, SCE&G announced its intention to file the current rate case. Hedge funds assuredly made assumptions about the details of the case, including its resolution, prior to the filing. If, when the Commission's decision is ultimately announced, the details fall short of those expectations, the hedge funds could put significant pressure on the stock either through outright sales, or short-selling, i.e, selling stock that is borrowed in anticipation that the price of the stock will drop before the borrowed stock must be replaced. Hedge funds seek to get ahead of the broader market and react to news before the market can. Accordingly, if hedge funds decide to make moves on SCANA's shares based on the order in this proceeding, they will begin to do so within hours of the release of the order.

Q. WHAT ROLE DO CREDIT AGENCIES PLAY IN INVESTORS' EXPECTATIONS?

A. In the wake of financial disasters, bankruptcies, and the ensuing severe erosion in investor confidence in the past few years, credit issues have become critically important not only to fixed income investors, but also to equity investors. While credit downgrades initially impacted only the most troubled companies, a spillover effect soon was seen on healthy utilities. Part of this was due to the fact that the rating agencies came under harsh criticism that they had failed to catch problems early enough in companies such as Enron Corp. As a result, they began to heighten their scrutiny of all entities under their watch and became far more proactive in making rating changes. As well, “headline risk” began to come into play, as investors worried that –when credit problems in an industry are in the headlines-- any company in the sector could be vulnerable to a downgrade. Thus, equity investors now closely watch the actions of the credit agencies, because any change in ratings can have a significant impact on a company’s stock price.

Q. WHAT HAPPENS WHEN A CREDIT DOWNGRADE OCCURS?

A. In the simplest terms, it becomes more expensive for a company to raise money in the capital markets because a downgrade raises a company’s risk profile and consequently, increases the cost of debt. And because of the increased linkage these days between ratings and stock prices, the price frequently reacts—sometimes quite strongly—to a downgrade. To take an extreme example, Moody’s Investors Service cut the ratings of Allegheny Energy and its subsidiaries to “junk,” or below investment-grade, status on October 1, 2002. The prior day, September 30, Allegheny’s stock price closed at $13.10. By October 8, when the company announced that it was in technical default with creditors due to its inability to meet higher collateral requirements prompted by the downgrade, the stock closed at $3.80. Thus, in the space of a week, Allegheny's stock price—and the value of a shareholder's investment—lost 71% of its value. Although this is an extreme example, it is nonetheless indicative of why the markets now watch changes in credit ratings so closely.

RETURN ON EQUITY FOR SCE&G

Q. HOW DO YOU BELIEVE SCE&G'S REQUESTED RETURN ON EQUITY OF 11.75% COMPORTS WITH INVESTORS' PERCEPTIONS?

A. I believe that the investment community would find an 11.75% ROE reasonable for SCE&G and that it would be seen as a positive signal that the history of constructive regulation is being carried forward in South Carolina. It is consistent with the Shields and Company report which indicated that investors are expecting the Company to be granted an ROE in the range of 11.7%. It represents a reasonable, but not excessive, reduction in the current allowed ROE of 12.45% that was granted two years ago in the Company's last electric rate proceeding.

Q. IN THE CURRENT LOW INTEREST RATE ENVIRONMENT, DO YOU CONSIDER INVESTORS' EXPECTATIONS REGARDING THE COMPANY'S PROSPECTIVE ROE AWARD TO BE REASONABLE?

A. Yes, I do. Although interest rates are near historically low levels, that factor is not the only one that investors are taking into account. I believe that, because of the greater risks that the industry is facing, investors are requiring a greater risk premium on their utility investments. Thus, I think that the broader interest rate environment should not be considered in isolation in terms of establishing ROEs for utility companies. And it should be noted that the recent low levels of interest rates appears to have passed, with the Federal Reserve's decision on June 29 to raise rates for the first time in several years and the Fed's warning that further increases could be forthcoming with any additional indications of mounting inflation. That alert draws attention to another risk that lies in an anemic ROE award at the current time. If SCE&G is given an ROE materially below the last allowed level of 12.45% at a time of rising interest rates, the Company's present under-earning position could be compounded. With unnecessarily weak financials, the need to access the capital markets could become greater as the risk of credit downgrades becomes even more pronounced, which in turn would result in a vicious negative cycle.

Q. WOULD YOU PLEASE COMMENT ON DR. BURTON MALKIEL'S ROE RECOMMENDATION?

A. Dr. Malkiel notes that the cost of equity capital for the Company is at least 10.5%. He further opines that there are good reasons for the PSC to maintain the existing 12.45% allowed return, namely the unusually low level of interest rates and anticipated rise in those rates, as well as SCE&G's having undertaken major investments during a period when required returns were higher. I agree with that opinion. Dr. Malkiel concludes his recommendation with the suggestion that the Commission assign an ROE range for the Company, so as to accommodate normal changes in economic conditions, territorial growth, weather, and unforeseen conditions. His proposed range of reasonableness for an equity return is 10.5% to 12.45%, with a midpoint of 11.5%. The Company's 11.75% request is well within the range and slightly below the two-thirds point in the range.

Q. WHY DO YOU LOOK AT THE HIGHER SIDE OF DR. MALKIEL'S RECOMMENDED RANGE?

A. As noted in the previous discussion on institutional investors' current views of the company, I believe that investors are expecting

SCE&G to be granted an ROE of 11.7%, and they want to see a continuation of the state's historically constructive regulatory environment. Investment risk in the electric utility industry is higher than it has been, and investors are requiring greater levels of compensation to assume that added risk. As an input in valuation models, earnings levels logically translate into the attractiveness of a stock, other factors being equal. A reasonable ROE award should sustain the Company's earnings power and affect the potential for future dividend growth. Conversely, a lower ROE could potentially undermine investors' expectations for ongoing dividend growth. These are important reasons why I would support an ROE in the upper half of Dr. Malkiel's range.

Q. COULD AN ROE AWARD THAT IS CONSISTENT WITH INVESTOR EXPECTATIONS ALSO BE EXPECTED TO PROVIDE BENEFITS TO SCE&G CUSTOMERS?

A**.** Absolutely. A higher ROE permits the realization of a stronger earnings stream. In turn, that can improve a company's stock's valuation prospects, which results in a higher stock price. Thus, when a company needs to tap the equity markets for capital needed to meet customer needs, it can get more for its money. Said another way, each share sold brings more equity into the Company with the same commitment by the Company to generate earnings and pay dividends to support the value of that share. In regard to debt financing, a higher ROE awarded to SCE&G would be viewed as a sign of constructive regulation and would be positive for the Company's credit rating. Importantly, customers' rates will eventually reflect this lower cost of capital.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes.

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BUSINESS EXPERIENCE:

1997- J.M. CANNELL, INC.

President of firm providing advisory services specializing in the electric utility industry.

1977 - 1997 LORD ABBETT & COMPANY, New York, New York

1995 - 1997 Equity Portfolio Manager. Responsibility for management and client servicing of ten institutional equity portfolios with total assets in excess of $700M. Actively and successfully involved in new institutional business marketing effort.

1994-1996 Associate Director of Equity Research. Provided oversight of departmental activities, including supervision of analysts' research efforts and support staff functions.

1992-1995 Portfolio Manager, America's Utility Fund. Full portfolio management responsibility for the fund since its May 1992 inception.

1978-1995 Securities Analyst. Sole responsibility for analysis of and stock recommendations for the electric utility and telecommunications industries. Other areas of coverage previously included housing (2 years) and pollution control (1 year).

Summer 1977 Research Assistant in Utilities.

1973-1976 UNIVERSITY OF COLORADO. Colorado Springs, Colorado.

Public Services Librarian
Instructor in Bibliography to undergraduate and M.B.A. students

1971-1973 CAMERON COLLEGE, Lawton, Oklahoma.

Reference Librarian

EDUCATION:

1978	COLUMBIA UNIVERSITY, MBA - Finance
1971	EMORY UNIVERSITY, M.Ln. - Librarianship
1970	MARY BALDWIN COLLEGE, B.A. - English

MEMBERSHIPS:

Chartered Financial Analyst (C.F.A.)
New York Society of Security Analysts
Association of Investment Management & Research
Wall Street Utility Group